Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Notice of Proposed Rulemaking on Recommended Decision of the Federal-State Universal Service Joint Board concerning the process for designation of eligible telecommunications carriers and the Commission's rules regarding high-cost universal service support	)	

COMMENTS OF PUBLIC UTILITY COMMISSION OF OREGON

These comments are submitted by the Public Utility Commission of Oregon ("Oregon Commission") in response to the Federal Communications Commission's ("FCC") Notice of Proposed Rulemaking regarding the Recommended Decision of the Federal-State Joint Board on Universal Service adopted June 2, 2004. ("Recommended Decision")[1]

Summary of Recommendations

The Oregon Commission believes that the entire federal Universal Service Fund ("USF") program is in need of fundamental review. The Commission should aim to put a new, comprehensive policy in place by the time the current five-year transition plan for rural local exchange carriers ("RLECs") ends about two years from now. In the interim, any limits placed on funding to control the growth of the USF should be transitional in nature and account for the reasonable expectations of all the rural carriers, whether incumbent local exchange carriers ("ILECs") or newly-designated competitive eligible telecommunications carriers ("CETCs").

The Oregon Commission makes the following recommendations:

1. The FCC should revisit the definition of the services that must be provided by Eligible Telecommunications Carriers ("ETCs").
2. The FCC should adopt permissive guidelines regarding financial resources, commitment and ability to provide the supported services, ability to remain functional in emergencies, and consumer protection;
3. The FCC should not adopt permissive guidelines regarding standby capability to provide equal access, local usage allowances, and high per-line USF support;

[1] Federal-State Joint Board on Universal Service, Recommended Decision, CC docket No. 96-45, 19 FCC Rcd 4257 (2004) ("Recommended Decision").

4. If necessary to control the growth of high cost support in the short-run, the FCC should cap the size of the fund and allocate the available resources proportionately to all ETCs. The scope of support should be all lines, not just primary connections;
5. The Joint Board and the FCC should develop replacement high cost support rules for implementation within two years. An example of a long-run solution is for the FCC to cap the Universal Service Contribution Factor and use an economic model to allocate available resources to the states. State commissions should have the flexibility to allocate the funds among ETCs within their boundaries. If necessary, state decisions could be made subject to FCC review pursuant to guidelines designed to protect interstate interests.

Designation of Eligible Telecommunications Carriers

Mandatory Eligibility Requirements

In the Recommended Decision, the Joint Board reviews existing mandatory eligibility requirements specified in either the statute or in FCC rules and, without much discussion, apparently concludes that they should be retained.[2] The Oregon Commission agrees, with one exception.

The FCC's current definition of the universal services provided by ETCs is voice grade access to the public switched network, local usage, DTMF signaling or its functional equivalent, access to emergency services, single-party service or its functional equivalent, access to operator services, access to interexchange services, access to directory assistance, and toll limitation for qualifying low-income customers.[3] The time has come to revisit this definition in light of rapidly evolving technology and consumer preferences.

In enacting the Telecommunications Act of 1996, Congress established universal service principles. One of those principles is:[4]

> (3) ACCESS IN RURAL AND HIGH COST AREAS.--Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

The Congress also defined universal service:[5]

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[2] Recommended Decision at 19.
[3] Recommended Decision at 19.
[4] 47 USC 254(b)(3)
[5] 47 USC 254(c)(1)

> (1) IN GENERAL.--Universal service is an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services.

Congress expressly contemplated that universal service would evolve in response to technological and market change. Substantial technological and marketplace change has taken place and the FCC's current rules need to be reexamined in the light of this change. The focus should be on the capabilities provided to consumers, not on the technology employed or the particular characteristics of the provider's rate structure. The use of DTMF signaling or its equivalent, for example, should not be a requirement for designation as an ETC. As another example, it is very clear that many consumers have shifted away from choosing service based on the amount of included local usage and instead choose service based on a package of usage that is statewide or national in scope. Usage charges and usage allowances, if they exist at all, are often for calling during the business day only, regardless of the location of the called party. Charges often don't apply on evenings and weekends. Local calling areas are a part of legacy rate structures that are gradually disappearing in the marketplace because they don't correspond to what consumers want.

The FCC should amend its rules in this proceeding to allow state commissions and itself to designate ETCs if the package of services offered provides equivalent or superior functionality, from the consumer's perspective, to that specified in the FCC's current rules. It should also ask the Joint Board to undertake a fundamental reexamination of the current definition of universal service.

Proposed Permissive Requirements

The Joint Board proposes to add permissive federal guidelines for use in ETC proceedings. According to the Joint Board, these guidelines:[6]

> should improve the long-term sustainability of the universal service fund, as only fully qualified carriers that are capable of, and committed to, providing universal service would be able to receive support.

This statement implies that, in the absence of permissive guidelines, ETCs have been or will be designated by state commissions or the FCC that are not fully qualified, or are unable or unwilling to provide universal service, and yet continue to receive universal service funding. The Oregon Commission is not aware of any analysis to support this.[7] In Oregon, two wireless CETCs have recently been designated after extensive hearings. The Commission unanimously decided that the carriers were ready, willing and able to provide universal service. Moreover, the Commission clearly laid the groundwork for ongoing intensive reviews as a part of the annual certification process. If the CETCs do

[6] Recommended Decision at 2.

[7] Anecdotal examples of alleged abuse by particular RLECs or particular CETCs, while deserving of investigation, do not provide a basis for policy.

not live up to their obligations as universal service providers, the Oregon Commission intends to withdraw its approval of their original certification.

The problem is not with ETC designations by state commissions and the FCC. State commissions can and do deny designation of applicants as ETCs when it is not in the public interest. The problem is that the current funding mechanism may lead to excessive demands on the USF in the future as ETCs are designated, even if those designations are appropriate. If so, the solution is to change the funding mechanism, not to change the designation process. Accordingly, our comments on the proposed permissive requirements for ETC designation are brief.

Adequate Financial Resources

Access to adequate financial resources by ETC applicants is certainly a very important public interest consideration, but, as the Joint Board notes, it must be applied with some care because access to capital, whether internally supplied or externally obtained in financial markets, is likely to depend on whether or not ETC status is granted. This guideline seems to duplicate a portion of the following guideline.

Commitment and Ability to Provide the Supported Services

This is clearly a very important public interest consideration. The Joint Board is correct when it observes that:[8]

> (s)tates should require a demonstration of capability and commitment because this will help them ensure that an ETC applicant is willing and able to provide the supported services throughout the designated service area and to be the sole ETC in a service area if the incumbent LEC relinquishes its designation.

The Joint Board suggests that a formal build-out plan is a good way to address this guideline and the Oregon Commission agrees.[9] The review of what many states have done is useful and demonstrates how seriously states take this issue. Given the nature of CETC funding, however, adopting a specific timetable during the initial designation process is not appropriate. The annual review process provides an appropriate set of checkpoints to ensure that reasonable progress is being made toward completion of the build-out plan.

With regard to standby capabilities to provide equal access if all other ETCs relinquish their designation in the service area, the Oregon Commission believes this issue should be resolved in the context of the proposed reexamination of the definition of universal service by the Joint Board. Until this review has been completed, we do not believe it is appropriate to require CETC applicants to spend money on a standby capability that is unlikely to be used.

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[8] Recommended Decision at 23.

[9] The Oregon Commission understands "build-out plan" to be a flexible concept encompassing the sorts of elements described in paragraph 24 of the Recommended Decision.

Ability to Remain Functional in Emergencies

This is certainly an important part of universal service capability and one that is routinely engineered in provider networks. The guideline may not be very useful is determining which ETC applicants to approve for designation. An advantage of multiple ETCs in a service area is that additional redundancy is available and different technologies have different strengths in dealing with emergency situations.

Consumer Protection

The Oregon Commission supports the Joint Board's suggestion that state commissions may properly impose consumer protection requirements as a condition of obtaining ETC status. The Oregon Commission is precluded from applying service quality standards to wireless carriers by state law, however.[10] We do intend to consider consumer complaints during the annual certification of CETCs in our state.

Local Usage

The Oregon Commission does not believe that this is a reasonable guideline for making CETC designations. A commission cannot properly evaluate the public interest with regard to granting ETC status based on a single element of an applicant's rate structure, particularly an element that may be starting to disappear in the marketplace. Many wireless carriers, for example, offer a choice of plans that include varying amounts of business day minutes and unlimited evening and weekend minutes. These plans cannot be evaluated or compared to wireline rate plans solely on the basis of the local usage included. If anything, this issue is more applicable in rural areas than metropolitan areas because local calling areas may be quite limited. One reason that residential customers subscribe to wireless service, for example, is that they can often make unlimited toll calls on nights and weekends at no extra cost.

Public Interest Determinations

The Joint Board offers a number of observations designed to provide guidance to the FCC and state commissions in making public interest determinations. The Oregon Commission will not generally comment on these observations with one exception. The Joint Board suggests that high per-line USF support to an RLEC in a particular study area may be an argument against granting ETC status to a competitive applicant.[11] The Recommended Decision goes so far as to seek comment on national benchmarks.[12] It may well be true in certain study areas that high per-line USF support is an argument against designating additional ETCs. In other study areas, high per line support may be an indicator that other technologies are more suitable for providing universal service. This is the great advantage of the statutory framework established by Congress under which the FCC or the state commissions can look at the particular circumstances in the study area in making a public interest determination. For that reason, any national benchmarks, above which designation of CETCs would be discouraged or denied, are singularly inappropriate.

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[10] ORS 759.450(8)

[11] Recommended Decision at 43.

[12] Recommended Decision at 44.

Scope of Support

Recent growth in universal service funding for CETCs is the impetus for the Joint Board's recommendation to limit the scope of support. For reference, the total USF has grown from $3.87 billion in 1998 to $5.63 billion in 2003. The high cost portion of the USF has grown from $1.69 billion to $3.27 billion during this period. In 2003, the high cost portion of the Fund accounted for 58% of the total USF. [13]

According to an analysis of USF projections for the third quarter of this year, annualized CETC high cost support will be $536.9 million, while ILEC support will be $3.248.6 billion, for a total of $3.785 billion.[14] This implies that CETC funding will be approximately 14% of high cost support and 9% of the total USF in the third quarter. [15] Looked at another way, support for CETCs by the USF accounts for less than one percentage point of the 8.9% Universal Service Contribution Factor for third quarter 2004.[16] The concern about CETC funding has to do with its rate of growth, not its absolute level. The policy implication of this is that the focus should be on a sound long-run solution, not a crisis response.

Not surprisingly, over 80% of universal service support for CETCs apparently arises from providing services in rural carrier territories.[17] Competitors are attracted to those areas receiving the highest level of support because they too will receive that level of support. If competitors use technologies that are cost effective in these areas, they have an opportunity to profit while simultaneously offering value to their customers. Depending on topography and other characteristics of the service territory, for example, wireless technology can sometimes be very cost effective in rural areas.

The policies in the Recommended Decision are apparently based on the assumption that services offered by CETCs are adjunct or supplemental in nature, and are therefore of lower priority. For example, the Joint Board writes:[18]

> Competitive ETCs now receive a small fraction of total high-cost support, but their support has increased dramatically over the past few years. Much of this growth represents supported wireless connections that supplement, rather than replace, wireline service.

A recent FCC report provides a perspective on this judgment about the marketplace.[19] ILECs reported 151.8 million access lines at the end of 2003, a decline of 6.7% from the prior year. Competitive local exchange carriers ("CLECs") reported 29.6 million access

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[13] Universal Service Administrative Company 2003 Annual Report, p. 1.

[14] Presentation by Daniel Mitchell, Senior Regulatory Counsel, National Telecommunications Cooperative Association at the NARUC Summer Committee Meetings, Salt Lake City, Utah, July 11-14, 2004, p. 7.

[15] Proposed Third Quarter 2004 Universal Service Contribution Factor, Federal Communications Commission Public Notice in CC Docket No. 96-45, DA 04-1613, Released June 7, 2004, p.2.

[16] Ibid., p.1.

[17] op. cit. 14, p. 7.

[18] Recommended Decision at 67.

[19] Local Telephone Competition: Status as of December 31, 2003, FCC Industry Analysis and Technology Division, Wireline Competition Bureau, June 2004.

lines, an increase of 19.3%. However, of this latter total only 6.9 million, or 23%, were provided via CLEC facilities. The remainder was provided by CLECs using unbundled network elements ("UNEs") or via resale. Facilities-based competition, therefore, accounted for just 3.8% of total access lines. In contrast, wireless subscribers grew 13% to 157 million. Many industry experts do not see these trends as evidence that wireless is an adjunct service. For example, Michael J. Balhoff, Managing Director of Legg Mason interprets these trends as a "clear and forceful shift in subscriber base."[20]

Primary Connection Concept

The Joint Board recommends that high-cost support be limited to a single connection that provides access to the public telephone network.[21] The concept is an interesting one and the Joint Board is to be commended for raising it. The Oregon Commission, however, opposes adoption of the primary connection concept. This proposal requires too much fundamental change in the way the Universal Service Fund is administered to be viable as a short-run solution. There are too many fundamental administrative and practical issues that would have to be addressed before it could be implemented. How is a household defined? How is the definition to be administered and monitored in practice? Who would maintain the database of households and their chosen primary connections? How would disputes among ETCs be resolved? Would a process like the equal access process have to be created in order for households with multiple connections to make their choice of which connection is primary? What is the impact on rural businesses with multiple connections? Would residential and business rates have to be restructured to include rates for "primary" and "non-primary" lines?

Lines as the Basis for Support

The Oregon Commission supports retaining the existing basis for universal service support in the short-run, that is, all access lines. This basis of support is established, well understood, and already in use. The main argument against retaining lines as the basis for support in the short-run is the concern that high cost support requirements will grow too rapidly as additional CETCs are designated. We believe that this issue can be addressed directly, rather than indirectly via changing the basis of support, as will be explained below.

Controlling USF Growth in the Short-run

The Oregon Commission believes that the Universal Service Contribution Factor may be approaching the upper limit of a reasonable range. Steps must therefore be taken to restrain the growth in the USF so that it doesn't grow faster than the rate at which the interstate telecommunications market (i.e. the contribution base) is growing.

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[20] Micheal J. Balhoff, CFA, Managing Director, Legg Mason, July 14, 2004, Getting it Right: Coordinating Policy Approaches for Rural Telecom, Slide 6. This is, of course, not to suggest that a majority of wireline subscribers currently regards wireless as a substitute for <u>all</u> of their wireline services. The Oregon Commission has not analyzed all of the implications of the shift in subscriber base Balhoff notes. For instance, we have not analyzed the shift as a possible rationale for deregulating local exchange service.

[21] Recommended Decision at 56.

At the same time, ETCs have made huge sunk investments in order to provide high quality, universal services in rural areas in the expectation that they will receive USF funding. RLECs in particular have been led to believe by the FCC that they will receive support based on their embedded costs for a five-year period ending in approximately two years.[22] Because CETC funding is based on RLEC funding in the latter's service area, however, rural CETCs also have an expectation of assured support for the customers they attract. This must be considered in arriving at an equitable decision in this proceeding if these expectations cannot be fully met.

The Oregon Commission recommends that the FCC cap the Universal Service Contribution Factor. The USF would then continue to grow in proportion to the size of the interstate telecommunications market. In the event that the USF based on a capped Contribution Factor is not large enough to accommodate all of the demands for support under current policy, the funds should be allocated. The Oregon Commission recommends the following approach in the short-run:

1. Determine the total amount available for high cost support.
2. Calculate each state's share of total high cost support in a base year, most likely 2003.
3. If the forecasted support requirement for a state would cause its share of the total available support for the nation to increase, reduce each ETCs support in that state by an equal percentage so that the state's share of total high cost support remains at its base year level.

The Universal Service Administrative Company ("USAC"), under the FCC's supervision, could administer this process as an extension of its current processes. It is administratively straightforward and involves the least possible disruption to the current process, appropriate for a short-run solution that should only be in effect for two years.

An important advantage of this approach is that it removes any incentive for a state commission to approve ETC applications primarily because it increases total high cost support for the state. Designation of additional ETCs would not cause the state's share of high cost support to increase and would therefore not unreasonably disadvantage other states.

If this proposal is adopted, there is no need for any capping or indexing of study area support. Likewise, there is no need for any restatement of support, any lump sum payments, or any "hold harmless" provisions.

Controlling USF Growth in the Long-run

The Universal Service Contribution Factor has grown to 8.9%. At this level of the Factor, important issues exist about the impact on efficient use of the nation's investment

[22] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Fourteenth Report and Order and Twenty-Second Order on Reconsideration, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244 (2001) ("RTF Order").

in telecommunications infrastructure, incentives for non-compliance or avoidance by some carriers, and the financial burden on telecommunications consumers. The concern that state commissions properly weigh the impact on the USF of their decisions to designate ETCs is legitimate. Two fundamental public policy issues are raised:

- How big can the USF get?
- How should the available funds be allocated among competing funding priorities and service providers?

There are many serious issues with the current approach. RLEC high cost support is based on embedded costs, a legacy approach which generates a host of problems. High cost support from the federal Universal Service Fund has evolved in the direction of relatively generous support for the RLECs, but not for the rural territories of the largest ILECs in the overwhelming majority of states.[23] Order of magnitude differences in funding have been noted. This anomalous situation has led to substantial concerns that the large ILECs may be disinvesting in, and even considering divesting themselves of, their rural territories in many states. Advanced services appear to be commonly available in RLEC territories, but not as commonly available in the rural territories of the large ILECs. Fundamental decisions regarding industry structure, capital investment and service availability are being strongly affected by the federal USF funding process.

The FCC has had great difficulty adopting USF high cost support rules that distribute the available funds to ETCs throughout the nation in a straightforward, equitable way that serves universal service policy goals. In part, this is because there are so many unique circumstances affecting the provision of universal service in different parts of the country. A long-run solution should allow for an allocation of funds based on the unique circumstances that exist state-by-state.

The Oregon Commission's believes that a long-run high cost support policy that deserves consideration is the following:

1. As in the short-run, the Universal Service Contribution Factor would be capped.
2. The Joint Board, and ultimately the FCC, would develop an economic cost model that would examine costs of universal service on a state-by-state basis based on the actual service characteristics of the state at a very disaggregated level. This cost analysis would not be dependent on whether or not the ILEC is a rural carrier.
3. The Joint Board, and ultimately the FCC, would use the model to determine each state's appropriate share of the total high cost support funds available. Each state's distribution from the fund would be recalculated based on the ratio of each state's cost to the total cost.
4. As the USF grows in line with the growth of the interstate telecommunications market, states would transition toward their targeted share of the available funds.

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[23] Legislation to address this problem has been introduced by Senator Gordon Smith (S. 1380) and Representative Lee Terry (H.R. 1582). The Oregon Commission supports passage of these bills.

5. There would be no federally mandated formula for how a state's high cost support funds would be distributed. A state commission would be free to allocate these funds to ETCs in a manner it found most compatible with the public interest based on the particular circumstances in the state.
6. Actual administration of the high cost support could be left in the hands of an entity like USAC, which would distribute the funds to ETCs pursuant to the direction of the state commission. The state commissions would never actually handle the funds. The funds would flow from interstate service providers to USAC or its successor and from USAC or its successor directly to ETCs.
7. As in the case of ETC designations, the FCC could determine the distribution of funds in the event that the state does not do so.

The Oregon Commission does not attempt to address here the tangle of legal issues associated with any attempt at federal-state cooperation in this area. If it is determined, as a legal matter, that the FCC cannot delegate to the states a determination of the appropriate distribution of high cost support among the ETCs operating in each state, then state commission determinations could be subject to final approval by the FCC based on clearly defined standards designed to protect interstate interests. State commission decisions would have the status of recommended decisions.

Our proposal brings the funding of universal service into line with the statutory framework established by the Congress. States have the statutory responsibility for the designation of ETCs based on the public interest. Our proposal would allow each state to decide the appropriate distribution of federal USF funds made available to the state based on the same unique local circumstances that are taken into account in designating ETCs. At the same time, ETC designations in one state would not affect the level of universal service funding in another state. The Joint Board and the FCC would be able to focus on the key national questions of how big the federal USF should be and how the available resources can best be distributed among states to accomplish universal service objectives.

Respectfully submitted,

PUBLIC UTILITY COMMISSION OF OREGON

Lee Beyer
Chairman

Ray Baum
Commissioner

John Savage
Commissioner

Public Utility Commission of Oregon
550 Capitol Street N.E. Suite 215
Salem, Oregon 97301-2551
503-373-1571